

State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Monthly Meeting September 23, 2009

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, September 23, 2009. The Treasurer called the meeting to order at 9:10 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio. Also present were Mr. Paul Campellone, of Adler, Pollock, and Sheehan and Mr. David Ursillo, of Rodio & Ursillo, Legal Counsel to the Commission; Mr. Allan Emkin and Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultants to the Commission; Ms. Lisa Tyrrell of State Street Corporation; Ms. Michelle Davidson of PCG, and Mr. Mark Dingley and other members of the Treasurer's staff. Mr. Robert Gaudreau was not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of August 26, 2009. Ms. Reback moved, Mr. Giudici seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Dr. Robert

McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio.

VOTED: To approve the Minutes of the August 26, 2009 monthly meeting.

General Consultant Report. Mr. Burns reviewed the information regarding asset allocation discussed in prior meetings. He explained there are only a few minor changes from the prior optimizations and the current one resulting in no material change. He pointed out that in optimization 4-A which is the proposed policy allocation, private equity was reduced from 9% to 7.5% and 1.5% was reallocated to non-US equity.

Ms. Reback inquired about the current percentage in US equity.

Mr. Burns stated that it is 43% and will be 36% and real return will move up to 10%.

Mr. Emkin commented there is also a slight reduction in international equity. Our goal is to reduce volatility and to give the portfolio more sensitivity to inflation. Even though that is not an issue now it will be at some time in the future.

Mr. Burns stated that implementation would happen over time after the policy is approved. He gave an overview of the changes in allocation classes before the Russell overlay.

Mr. Emkin mentioned that today the board is considering the concept not the implementation.

Ms. Reback asked if this is a good time to sell equity given the

current market.

Mr. Emkin stated the goal is to make a long term decision on asset allocation that is not based on where the markets are today.

Treasurer Caprio remarked when looking at the larger picture we will still be over 60% in equity which is an aggressive position. Our target return is 8.25% therefore we need an allocation which produces that.

Ms. Booth Gallogly questioned how we get the rebalancing in private equity.

Mr. Emkin commented with the slow down in performance, it may self-adjust. Going forward good opportunities should continue to be considered in a measured way.

Treasurer Caprio said the reality is the public equity market has the allocation where it should be at +/- 1%.

Treasurer Caprio entertained a motion, with the understanding that following will be a presentation on the real return asset class and policy details, to approve the asset allocation # 4A presented by PCA on page 5 of the September 23, 2009 presentation subject to orderly implementation with the advice of the commission's consultants and board approval of those initiatives.

Ms. Reback moved, Dr. McKenna seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio.

VOTED: To approve the asset allocation # 4A presented by PCA on

page 5 of the September 23, 2008 presentation.

Treasurer Caprio introduced the real return portfolio policy investment statement.

Mr. Burns remarked that the board has approved a 10% allocation to real return asset class. Now, we turn to implementation. He reviewed the document: Real Return Portfolio Investment Policy Statement. The primary objective of this portfolio is to hedge against unanticipated inflation. The second objective is to bring an additional return source aside from US & non-US equity. We want to populate the 10% allocation with products that will impact return.

Treasurer Caprio observed that as part of implementation we would look for products that are low fee and as liquid as possible.

Mr. Burns commented that you are trying to build a portfolio with inflation protection and beta return.

Mr. Emkin commented that all other asset classes have a less timely link to inflation than TIPS that is why you want diversification.

Ms. Booth Gallogly asked if the ranges showing are due to implementation.

Treasurer Caprio asked how the percentages were determined.

Mr. Burns explained that to get to CPI +400 basis points, the portfolio needs some inflation linked higher returning products.

Mr. Costello asked if the further we get from CPI, the less it is linked to inflation.

Mr. Burns stated that is correct.

Mr. Costello asked, in relation to other funds, how does our fund

compare.

Mr. Emkin noted that the range is 300 to 500 basis points above CPI.

Mr. Costello questioned if initially the goal should be towards the CPI TIPS number.

Mr. Emkin stated that a moving benchmark that reflects the transition over time could be included in the policy.

Ms. Booth Gallogly asked if there are any investments in real return where we would need to formulate an exit strategy when making the investment.

Mr. Emkin stated that for the first couple of years all products would have a public market and we are looking at investments that have only a thirty, sixty or ninety day lock-up.

Mr. Giudici requested a clarification on the risk analysis for commodities.

Mr. Emkin commented the biggest risk is leverage and we will not recommend you lever the portfolio. The goal is to get exposure to a broad basket of commodities that will have a relationship to inflation over time.

Mr. Burns noted that to achieve CPI +400 bps does not require added risks.

Ms. Reback inquired about the reasoning for a large percentage of commodities.

Mr. Burns replied that timber and infrastructure are long-term investments therefore the more liquid investment is the best way to start in the new class.

Mr. Emkin stated as you review policies in years to come you can

modify policy to best fit investment strategy.

Treasurer Caprio noted that the portfolio has been well served by TIPS for the past eight years.

Mr. Burns concluded by saying the policy reflects industry best practices.

Mr. Emkin mentioned the phased benchmark will be included.

Ms. Booth Gallogly asked if each category would have a benchmark.

Mr. Emkin noted that each strategy currently has a unique benchmark with the market being the broad benchmark.

Ms. Booth Gallogly asked if each commodity would have a benchmark and will there be variation.

Mr. Emkin replied when we come back to you on this bucket we will go over the various benchmarks.

Mr. Burns noted the issue is addressed on performance objectives on the first page.

Treasurer Caprio entertained a motion to approve the real return portfolio investment policy as presented to the commission defined in the handout Real Return Portfolio Investment Policy Statement.

Ms. Reback moved, Dr. McKenna seconded.

Mr. Costello asked if we should include the transition benchmark.

Mr. Emkin replied we will include a transition benchmark.

Treasurer Caprio withdrew the motion.

He entertained a motion to approve the real return portfolio investment policy as presented to the commission defined in the handout Real Return Portfolio Investment Policy Statement and we will transition to the benchmark with a policy presented to the board

at a future meeting.

Ms. Reback moved, Dr. McKenna seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio.

VOTED: To approve the real return portfolio investment policy as presented to the commission defined in the handout Real Return Portfolio Investment Policy Statement and we will transition to the benchmark with a policy presented to the board at a future meeting.

Legal Counsel Report. Legal Counsel had no report.

Chief Investment Officer Report. Mr. Goodreau stated before giving his report that he is presenting the proposal to add a new asset class to the short term cash pool because Mr. Izzo and Mr. Marr are in a meeting with Taxation on pressing issues; they deserve the recognition for the work involved in this presentation.

The cash management proposal, Temporary Liquidity Guarantee Program (TLGP), was initiated through the FDIC last year. In August the FDIC extended the program through June 30, 2010. We are currently being offered 10 to 12 basis points on certain current investment products; TLGP enhances the yield on very short term liquidity pools or noninterest-bearing account transactions defined by US Treasury as less than or equal to 50 basis points. The

recommendation is to create a new asset class – Government Insured Deposits with the same guideline mandates as collateralized deposits - 75% maximum and 35% with one institution. Relationships will be with existing board approved vendors. Treasury staff will verify with the FDIC and receive certification from the vendor that they are participating in the program. Benefits of the program are a possible \$120,000.00 to \$240,000.00 in additional interest income from \$35,000,000 to \$60,000,000 in operating cash with very little risk. The asset class will expire when the program ends.

Mr. Reilly asked if this is an asset class or policy under cash management.

Mr. Goodreau stated this is actually a guaranteed deposit, we are not buying Treasuries. Treasurer Caprio asked how this relates to the government policy on surety money market funds that just expired.

Mr. Goodreau stated the money market provision just sunset and it was for existing troubled money markets. This is different because it is intended for liquid deposits (daily liquidity) and when the program ends all deposits will mature and be redeemed.

Treasurer Caprio entertained a motion to add a temporary asset class for TLGP deposits. Dr. McKenna moved. Mr. Reilly seconded, and the following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio.

VOTED: To add a temporary asset class for TLGP deposits.

Mr. Goodreau commented that the fund had another spectacular month. The portfolio is up 10% for the year, and without private equity and private real estate it would be up over 17% this (calendar) year. We have come a long way in three months. The board's efforts are commendable on the total return program. We will always be looking for new tools to manage the fund in a volatile environment.

Ms. Reback inquired how many bad years have we had in terms of the five year slow down.

Treasurer Caprio commented there is 2 year lag; the fiscal year that was closed June 30, 2009 will not be felt for one and one half years. The best information on where we stand is the actuarial presentation to the Retirement Board. Among the findings it showed: MERS is 90% funded, Teachers and State Employees is 60% funded. MERS has one employee for every retiree, Teachers and State Employees have more retirees than employees. He asked that the report be sent to SIC members.

Treasurer Caprio asked Ms. Davidson if she would like to state anything on behalf of PCG even though she is not on the agenda.

Ms. Davidson told the board the issue of the 7.5% asset allocations for private equity will be monitored. There will be isolated softness with the 2006 -2007 vintages in the foreseeable future. In the current environment 2009 - 2010 is better for private investment. The measured approach the Treasurer mentioned is the best way to go forward.

Mr. Reilly asked what the capital call outlook is.

Ms. Davidson said this should be slow through 2009 and below historical norms through the first 6 months of 2010 then it should ramp up as liquidity returns to the market.

Mr. Costello questioned which performers were stand out in our portfolio.

Ms. Davidson stated that the large buy-out funds are doing better for the second quarter, valuations should be up between 9% and 12%; on the negative side venture capital is down because of the exit environment.

Treasurer's Report. Treasurer Caprio asked, in addition to these remarks, that his report include his comments throughout the meeting. He informed the group that treasury staff and PCG have embarked on an endeavor to contact our general partners to have a discussion about our fee structure. He stated he will be meeting with PCG about their relationship with Rhode Island going forward.

He remarked that he is pleased that these meetings have taken a proactive stance rather than simply reviewing investment results. He thanked the board for the time in developing a solid policy to impact the future results of the fund.

New Business. There was no new business.

There being no new business, the Treasurer entertained a motion to adjourn. Ms. Reback moved, Dr. McKenna seconded and the subsequent motion passed. The following members voted in favor:

Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:14AM.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**